

**ILLINOIS COMMERCE COMMISSION**

**DOCKET No. 13-0301**

**REVISED REBUTTAL TESTIMONY**

**OF**

**RONALD D. STAFFORD**

**Submitted on Behalf**

**Of**

**AMEREN ILLINOIS COMPANY  
d/b/a Ameren Illinois**

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VI. **PROPOSED ADJUSTMENTS THAT WILL REQUIRE A CHANGE TO THE  
FORMULA RATE TEMPLATE**

**Q. Have parties proposed adjustments that would require changes to the formula rate template?**

**A.** Yes. Several adjustments recommended by Staff and Intervenors would require changes to the formula rate template. However, although I am not a lawyer, I understand that such changes cannot be made in the current proceeding, but must be made in a separate proceeding before the Commission, pursuant to Section 9-201.

**Q. Which proposed adjustments would require a change to the formula rate template?**

**A.** I have identified the following proposed adjustments that will require a change in the formula rate template. AIC witness Mr. Robert J. Mill further explains why these changes cannot be made in this proceeding without a filing under Section 9-201 of the Act. I also address Items (7) and (8) later in my testimony.

- (1) Ms. Ebrey's proposed adjustment for Uncollectible Expenses in the Reconciliation Year which does not conform to Sch. FR A-1 REC. The change would require a different reference on line 2a and the addition of a footnote similar in form to the footnote on Sch. FR A-4.
- (2) Ms. Ebrey's proposal to not gross up Uncollectible Expenses for changes in the Reconciliation with Interest and/or ROE Collar adjustments, which does not conform with Sch. FR A-1. The change would require modification to a number of line items on Sch. FR A-1 with the addition of a footnote on Sch. FR A-1 REC, and source changes to Sch. FR A-3, Sch. FR A-4, and Sch. FR C-4.
- (3) Mr. Ostrander's proposed adjustment to use year-end rather than average balances of Materials & Supplies and Customer Deposits in the Filing Year calculation of Rate Base, which does not conform with Sch. FR B-1. The change would require modification to a number of lines on Sch. FR B-1 and changes to both App 1 and App 2.
- (4) Mr. Ostrander's proposal for two cash working capital (CWC) calculations. App 3 has only one calculation. Since the inputs to the template on App 3 can be based on either Filing Year or Reconciliation Year data, but not both, the Company has

modified its inputs into App 3 to align with the Reconciliation Year (rather than Filing Year) Revenue Requirement. This modification should partially alleviate one of Mr. Ostrander's concerns discussed on lines 141-144 of his Direct Testimony (ICC Staff Ex. 2.0) and is workable within the existing template without requiring a Section 9-201 filing revision. Furthermore use of one CWC tying to the Reconciliation Year is consistent with the Order (Appendices A and B) issued for ComEd in Docket No. 12-0321, which authorized the same CWC in both the Reconciliation Year and Filing Year Rate Base using Reconciliation Year inputs. Since CWC is an input for Reconciliation Year Rate Base, it is important that when only one CWC calculation is authorized under the formula rate protocols, the calculation be based on the Reconciliation Year. To add a second CWC calculation would require the addition of a second App 3 with modifications to Sch. FR B-1.

(5) Mr. Ostrander's proposed adjustment to Filing Year Depreciation Expense for changes in depreciation rates which does not conform with App 8. This change would require the addition of three lines on App 8 and a source reference modification to Sch. FR C-2.

(6) Mr. Ostrander's proposed adjustment to Reconciliation Year Depreciation Expense would also require additional modification to FERC Form 1 inputs on App 8 beyond those required to implement the change in (5). Since the depreciation rate changes occurred in 2013, however, such a change does not appear to be consistent with other components of the calculation for Reconciliation Year inputs which are based on 2012 actual information. The Company does not believe such a change to Reconciliation Year Depreciation Expense is consistent with the requirement to use 2012 information for the 2012 reconciliation.

(7) Mr. Effron's proposed adjustment to the ROE Collar would require a change to Sch. FR A-3. This proposal is addressed in a later section of my testimony.

(8) Mr. Brosch and Mr. Effron's proposed adjustment to the Reconciliation with Interest calculation would require multiple line item changes to Schedule FR-4. This proposal is addressed in a later section of my testimony.

654 **VIII. ADJUSTMENTS PROPOSED BY THE PEOPLE OF THE STATE OF ILLINOIS**

655 **A. Actual Rate Base to be Used in Collar Calculation**

656 **Q. What is AG witness Mr. David J. Effron's proposal with respect to the amount of**  
657 **rate base used to calculate earned return on equity in the collar computation?**

658 **A.** Mr. Effron recommends using average rate base instead of year-end rate base to calculate  
659 the common equity balance to for the purpose of determining the earned return on equity (ROE)  
660 for the collar calculation. He argues that this approach will reflect the actual capital supplied by  
661 investors to support the Company's rate base over the course of a year, and states that use of  
662 year-end figures will either understate or overstate the return earned on common equity,  
663 depending on whether the common equity balance is growing or decreasing.

664 **Q. Is Mr. Effron's proposed change to Sch. FR A-3 consistent with the approved**  
665 **formula rate template?**

666 **A.** No. As discussed further by Ameren witness Mr. Robert J. Mill, Mr. Effron's proposal  
667 would require changes to the Commission approved formula rate template. Such changes can

668 only be made in a Section 9-201 proceeding.

669 **Q. Do you agree with Mr. Effron's assertion that applying the common equity ratio to**  
670 **average, as opposed to year-end, rate base will produce a figure that accurately represents**  
671 **the capital supplied by equity investors?**

672 **A.** No. Mr. Effron's proposal creates a mismatch between the year-end rate base and year-  
673 end capital structure required by the EIMA, and the average balances for rate base he proposed  
674 to use in determining the equity balance for the collar calculation. His proposal has the effect of  
675 replacing year-end capital structure balances with average capital structure balances, including  
676 common equity. In other words, he proposes to apply year-end capital structure ratios to an  
677 average rate base amount to produce something other than a year-end common equity balance.  
678 Ultimately, Mr. Effron's proposal would, by calculating a lower balance of common equity for  
679 purposes of the ROE collar (due to applying the common equity percentage to a lower average  
680 rate base), tend to artificially inflate the earned ROE relative to authorized. It is impossible to  
681 get a proper measurement of capital supplied by equity investors when you establish  
682 reconciliation requirement based on year-end rate base values and apply the result to a common  
683 equity balance based on an average.

684 **Q. Can you provide an illustration of why Mr. Effron's method of mixing average with**  
685 **year-end balances does not work?**

686 **A.** Yes. Let's say the Company issues new long-term debt and common equity in the  
687 amount of \$100 million on February 1<sup>st</sup> of a given year. That additional debt and equity  
688 obligation would be fully recognized as a component of the capital structure financing rate base  
689 for the reconciliation revenue requirement calculation. A full year of interest expense would be

recognized as interest expense in calculating the ROE collar and the full amount of equity would also be included in the capital structure. Under the Company's methodology of using year-end rate base for the collar calculation, the two components would be synchronized. Year-end rate base used to calculate reconciliation revenue requirement would be matched with year-end capital structure components, including the full value of the new \$100 million debt and equity issue, to derive a return on equity that synchronizes year-end balances of capital invested in rate base with sources of such funding provided from debt and equity included in the year-end capital structure. Under Mr. Effron's method, the ROE collar computation would only include 50% of the debt and equity issuance even though rates were set based on inclusion of full balance on hand at year-end.

**Q. Do you agree with Mr. Effron's assertion that use of year-end rate base will either overstate or understate the actual ROE earned on common equity, depending on whether the common equity balance is growing or decreasing?**

**A.** No. Just the opposite is true. As illustrated above, the only measurement method that properly measures the actual ROE earned on common equity is a method that measures both rate base and capital structure using the same approach.

**Q. Do you believe Mr. Effron has properly taken Senate Bill 9 into account in his proposal?**

**A.** No. Mr. Effron contends that continued use of average rate base in the ROE collar calculation is appropriate despite enactment of Senate Bill 9 (Public Act 098-0015), which required that year-end rate base be used to calculate the revenue requirement in the reconciliation year. However, the overall effect of Public Act 098-0015 was to establish that year-end values



for rate base and capital structure should be used in setting formula rates. And Section 16-108.5(c) states the ROE collar must be "calculated using costs and capital structure approved by the Commission as provided in subparagraph (2) of this subsection (c) [providing for year-end capital structure], consistent with this Section, ...." Thus, although I am not a lawyer, it does not appear to me that use of an average rate base amount for the collar calculation is consistent with the EIMA. Furthermore, in response to AIC-AG 1.07 (attached as part of Exhibit 9.7), Mr. Effron acknowledges that Public Act 098-0015 "requires the use of year-end capital structure ratios". He is correct, and Public Act 098-0015 also requires the use of the year-end capital structure. Mr. Effron's ROE collar calculation inappropriately imputes average capital structure balances, including common equity, to the ROE collar calculation, thus understating the common equity amount supporting reconciliation revenue requirement.

**Q. Under Mr. Effron's proposal, will the Company have the opportunity to earn its authorized rate of return?**

**A.** No. If utilization of average rate base investment rather than year-end rate base investment results in a downward adjustment under the ROE collar calculation, the Company will not have the opportunity to earn the authorized rate of return based on year-end rate base pursuant to PA 098-0015. A downward adjustment to the ROE via the collar calculation, under Mr. Effron's proposal, restrains the return to a return on average rather than year-end investment, which is not authorized under PA 098-0015.

**Q. Please summarize your comments on Mr. Effron's proposed change to the ROE calculation.**

**A.** Mr. Effron's proposal to use average rate base and capital structure components creates a

mismatch that will result in misleading and inaccurate results under the ROE collar calculation.

His proposal is not consistent with the express provisions of PA 098-0015, and would not provide the Company an opportunity to earn its authorized rate of return when a downward adjustment to the ROE collar results from the use of average rather than year-end rate base.

**B. Reconciliation of Revenue Requirement with Interest Calculation**

**Q. Please summarize Mr. Brosch and Mr. Effron's proposals with respect to the reconciliation with interest calculation.**

**A.** When calculating the reconciliation interest amount, both Mr. Brosch and Mr. Effron recommend reducing the reconciliation amount, applicable to both over and under-recoveries, by the applicable tax rate to derive a reconciliation balance net of deferred income taxes before application of the reconciliation interest rate. Mr. Brosch refers to this netting approach as equivalent to the Company's actual incremental invested capital in financing such balances (for under-recoveries). Both Mr. Brosch and Mr. Effron argue that, for under-recoveries, the Company has additional cash due to the fact that deferred income taxes have been recorded for the revenues due to be collected in rates via the reconciliation, but relevant income taxes are not actually paid until the reconciliation balance is recovered. Thus, they propose that this purported cash benefit from deferred income taxes should be netted against the reconciliation balance prior to calculation of interest for the reconciliation balance.

**Q. Is their proposal consistent with the formula rate template?**

**A.** No. As discussed further by Ameren witness Mr. Robert J. Mill, their proposal would require changes to the Commission approved formula rate template. Such changes can only be made in a Section 9-201 proceeding.

**Q. Is Mr. Brosch and Mr. Effron's recommendation to change the reconciliation with interest calculation by netting deferred income taxes consistent with the express provisions of PA 98-0015?**

**A.** No. There is no provision in the EIMA to determine reconciliation interest amount net of taxes. The express provisions of PA 098-0015 defines the interest applied to the reconciliation.

Section 16-108.5(d)(1) as amended for PA 098-0015 states in pertinent part:

(1) .... The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (determined using a year-end rate base) that uses amounts as reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year). *Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year*, the charges for the applicable rate year.

(emphasis added).

While I am not a lawyer, my reading of the Act expressly states that interest is to be applied to the reconciliation balance, and not the reconciliation balance net of deferred income taxes.

**Q. Please respond to Mr. Brosch and Mr. Effron's claim that deferred income taxes recorded by the Company on any reconciliation under-recoveries will provide a source of cash to the Company.**

**A.** There is no cash received from deferred income taxes, as the deferred income taxes correspond to accounting accruals for revenues to be received. If the Company had billed and collected the revenues that corresponded to the recording of deferred income taxes, then there

would be actual cash in hand. Under that scenario, the deferral of income tax payments would generate cash benefit. However, in this case, there is no source of cash to support AG's proposed netting of income taxes against the reconciliation balance.

**Q. Can you provide an example to illustrate your point?**

**A.** Yes. The AG proposes this netting approach to both over and under-recoveries. Let's use an example of a 5-year individual home mortgage of \$100,000. A portion of each month's payment is for principal (similar to the reconciliation balance on Sch. FR A-4) and a portion is interest (similar to interest on the reconciliation balance on Sch. FR A-4). At the beginning of the 5-year payback period, the mortgage company has \$0 of the \$100,000 of actual cash in hand. If the mortgage company records either the \$100,000, or interest on the \$100,000 as revenues to be collected, and in turn records a deferred income tax offset on its financial statements for taxes to be owed on revenues yet to be collected, there will not be any additional cash, or any reduction in invested capital, as the AG implies. Rather there will be recognition within the financial statements of \$100,000 to be collected, with interest, in future periods, for which the mortgage company will have to pay income taxes, in future periods, when the amounts owed are billed and collected from the customer. The cash associated with the deferred income tax is not yet received because the customer has not yet been billed, and the mortgage company has not yet collected payment from the customer.

**Q. You stated previously that the AG has claimed that deferred income taxes provides a source of cash to the Company. Can this claim be reconciled with the operation of the reconciliation balance with interest calculation?**

**A.** My conclusion is that the AG cannot reconcile this point with operation of the

reconciliation balance with interest calculation. When Mr. Brosch was asked for the actual source of cash for each of the reconciliation revenue requirement components, his response in AIC-AG 1.04 (attached as part of Exhibit 9.7) was: "The source of cash is the deferral of income tax payment liability to future periods". But the question is not whether the Company can defer paying income taxes, but rather when and how the Company will get *actual* cash in hand from the reconciliation balances. The answer can be found in Mr. Brosch's response to AIC-AG 1.05 (attached as part of Exhibit 9.7) in which he states that "Income taxes will become payable when reconciliation revenues can be billed to and **collected** from customers" (emphasis added). As discussed previously, and as the illustration above showed, the Company will not have actual cash in hand to pay income taxes until customers have been billed and the Company has collected the reconciliation balance, with interest. This point is again confirmed with Mr. Effron's response AIC-AG 1.09 (attached as part of Exhibit 9.7) where he states: "Mr. Effron agrees that any 2013 over- or under-recovery will not be credited to, or collected in customer rates until calendar year 2015."

**Q. Do have additional concerns with the AG's proposal to net deferred income taxes against the reconciliation balance?**

**A.** Yes. It is not clear if the AG's proposal is to adjust the entire reconciliation balance to be recovered from or charged to customers or just adjust the calculated interest amount. If the former, however, I have additional concerns. A netting of deferred income taxes against the reconciliation balance will not provide sufficient monies to the Company to fully collect reconciliation amounts owed and pay income taxes on the amounts billed and collected. For example, if the Company is owed \$1 million from customers under the reconciliation revenue requirement, but only can collect \$580,000 due to netting of deferred income taxes at the rate of

829 42%, collections from customers will be short by the \$420,000 amount of deferred income taxes  
830 netted against the reconciliation balance, as recommended by the AG. Under this scenario, the  
831 Company would not be entitled to collect the full revenue requirement shortfall of \$1 million to  
832 cover the shortfall in recovery of other components of revenue requirement i.e. operating costs,  
833 debt interest, and return on equity capital invested and still pay income taxes on amounts  
834 collected. Said another way, if the Company only collects \$580,000 and pays income taxes on  
835 that amount, the amount remaining to cover the shortfall in revenue requirement will only be  
836 about \$336,000 (\$580,000 multiplied by 42%) rather than the \$580,000 need to cover the  
837 shortfall in revenue requirement other than income taxes.

838 **Q. Is netting deferred taxes a benefit to the utility when there is a credit balance?**

839 **A.** No. The same principle applies whether the reconciliation reflects a debit or credit  
840 balances. With a credit balance, the Company is still required to refund the full amount owed to  
841 ratepayers, with interest. It would be incorrect to reduce the refund amount by the deferred tax  
842 effect when customers are entitled to the full reconciliation refund amount with interest.

843 **Q. Please summarize your response to Mr. Brosch and Mr. Effron's proposed**  
844 **modification to the reconciliation of revenue requirement with interest calculation.**

845 **A.** Mr. Brosch and Mr. Effron's proposal to adjust the reconciliation balance for deferred  
846 income taxes should be rejected for a number of reasons. First the recommendation is not  
847 consistent with the Commission approved formula rate template. Second, the proposal is at odds  
848 with the express provisions of SB 9 and PA 98-0015. Third, there is no source of cash to support  
849 the AG's recommendation, and the AG's own responses to AIC data requests indicate cash will  
850 not be received until customers are billed and collected in rates. Fourth, any proposal to net the

851 total reconciliation balance for deferred income taxes would not provide sufficient funds to the  
852 Company to cover the revenue requirement shortfall and pay income taxes on amounts collected.

